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TREASURY FOR OASIA/ICB/VIMAL ATUKORALA  
TREASURY ALSO PASS FOR OCC/EILEEN SIEGEL  
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SUBJECT: AUSTRIA'S 2006/2007 OUTLOOK - SOLID GROWTH AND  
MORE OPTIMISM

REF: Vienna 190

Summary

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¶1. Two Austrian economic institutes have presented growth projections of 2.4-2.5% for 2006 and 2.0-2.2% for ¶2007. Although export growth remains the engine driving the economy, industrial production and business investment should increasingly contribute to growth. Private consumption remains weak, below a typical rate at the early stage of an upswing. The unemployment rate of 5.2% remains historically high and will likely be a major campaign issue in fall national elections. Inflation should remain low at 1.4-1.7% in 2006. End Summary.

Growth in 2006 and 2007 - Moderate But Solid

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¶2. The Austrian Institute for Economic Research (WIFO) and the Institute for Advanced Studies (IHS) recently presented revised projections for 2006 and 2007, with only marginal changes from December 2005 estimates. For 2006, WIFO maintained its 2.4% growth forecast, while IHS raised its growth projection from 2.3% to 2.5%. Austrian exports will again drive economic growth in 2006. Export growth will benefit from a continued strong global environment, as well as from additional temporary demand in Germany prior to the 2007 VAT increase. Notably, the upswing has developed a domestic force, i.e., strong industrial production, growing tourism revenue, and an anticipated rise in business investment, which has been weak in 2004/2005. Private consumption will pickup somewhat, but it will not contribute significantly to the upswing.

¶3. Projections for 2007 for slightly lower growth of 2.0% (WIFO) and 2.2% (IHS) remained unchanged. The institutes predict slower growth in 2007, as additional domestic demand fails to offset the negative impact of lower global demand and much lower demand from Germany due to the VAT increase. Nevertheless, both WIFO Director Karl Aiginger and IHS Director Bernhard Felderer stressed that lower growth in 2007 will likely be only an aberration of an upward growth trend.

## Problem Areas - Private Consumption, Unemployment

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¶4. Economists expect private consumption will grow more robustly than in 2004/2005 thanks to rising incomes, easing inflation and a stable savings rate of approximately 9.5% of disposable incomes. WIFO and IHS now forecast private consumption to grow at a real rate of 1.9-2.1% in 2006 and 1.8-2.0% in 2007. Despite an improvement from 2004 (+0.8%) and 2005 (+1.4%) and a 1.0% annual average during the last five years, the growth in private consumption remains below the long-term trend of 2.3%. Moreover, the growth rate is below a typical rate at an early phase of an upswing.

¶5. The number of employed should decline by 3,000 in 2006. This does not indicate a fundamental reversal of labor market conditions. The unemployment rate will remain around 5.2% in both 2006 and 2007. In 2007, the number of unemployed could rise again slightly, as the number of people in job training (and therefore not technically unemployed) falls due to likely funding shortages. This is above the level in recent years of some 4.5%. Labor market problems will therefore persist and will continue as a high priority for the government, especially in the run-up to national elections this autumn.

## Risks for the Forecasts - Exchange Rates and Oil Prices

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¶6. Both WIFO and IHS voiced confidence that downward risks have diminished in the last three months. A major

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uncertainty is whether or not businesses will actually implement current plans for increased investment spending. Globally, a possible slowdown in U.S. economic growth, as well as persistent concerns about the U.S. budget deficit, current account deficit, and real estate bubble, remain downside risks. Oil prices should remain stable at the relatively high current level, but this is also a downside risk.

## Assumptions for Growth Forecasts

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¶7. The institutes based their revised 2006/2007 forecasts on the following assumptions:  
-- U.S. economic growth of 3.3% in 2006 and 3.0% in 2007;  
-- Euro area growth of 2.0-2.1% in 2006 and 1.8-1.9% in 2007;  
-- EU-25 growth of 2.2-2.3% in 2006 and 2.0% in 2007;  
-- German growth of 1.9-2.0% in 2006 and 1.2-1.5% in 2007;  
-- oil prices of \$59-60 per barrel in 2006 and \$58-60 in 2007; and  
-- dollar/Euro exchange rates of 0.81-0.86 in 2006 and 0.81-0.89 in 2007.

## Inflation Easing, Interest Rates Tending Upwards

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¶8. Inflation eased due to a stabilization of oil prices and statistical effects, such as the leveling off of price increases for housing and health services. The institutes now project an inflation rate of 1.4-1.7% in 2006 and 1.6-1.9% in 2007. Given current low interest rates, Aiginger expects the European Central Bank to raise interest rates once more in 2006. Most economists, including Felderer, expect a series of increases, because the Euro-zone inflation remains above the 2% target.

## Public Finance

¶9. The 2005 total public sector deficit was only 1.5% of GDP – less than the 1.9% budgeted. In 2006, cost-savings from administrative reform will not offset the continued impact of 2005 income and corporate tax cuts and higher expenditures in many areas, such as a civil service wage increase. Therefore, the institutes expect a deficit of about 1.8–1.9% of GDP in 2006. For 2007, the institutes expect a deficit of between 0.8 and 1.5%. The GoA's 2005–2008 Stability Program foresees a deficit of 0.8% of GDP in 2007 and a balanced budget by 2008.

## ¶10. Statistical Annex

### Austrian Economic Indicators (percent change from previous year, unless otherwise stated)

	WIFO project. 2006	IHS project. 2006	WIFO project. 2007	IHS project. 2007
Real terms:				
GDP	2.4	2.5	2.0	2.2
Manufacturing	5.0	n/a	4.2	n/a
Private consumption	1.9	2.1	2.0	1.8
Public consumption	1.3	1.0	0.5	0.5
Investment	3.2	4.0	2.7	3.2
Exports of goods	6.5	6.0	5.7	5.8
Imports of goods	5.5	5.7	5.4	5.0
Nominal Euro billion equivalents:				
GDP	256.9	256.5	267.2	265.4
Other indices:				
GDP deflator	1.8	1.5	1.9	1.2
Consumer prices	1.7	1.4	1.9	1.6
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Unemployment rate	5.2	5.1	5.2	5.1
Current account (in percent of GDP)	0.6	0.4	0.7	0.6
Exchange rate for US\$ 1.00 in Euro	0.86	0.81	0.89	0.81

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